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SIPDIS

DEPARTMENT FOR EB/IFD/OIA AND L/CID

SENSITIVE
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SUBJECT: GOS SELLS TRAVEL AGENCY AS AMCIT WINS ARBITRATION

REF: 06 BELGRADE 1001 AND PREVIOUS

SUMMARY

¶1. (U) On April 20, the Government of Serbia (GOS) sold its 70 percent share in the Putnik travel agency - and its valuable real estate holdings - to Cyprus-based Acciona Investments Limited for EUR 38 million. This rapid-fire sale on the Belgrade Stock Exchange was concluded in the midst of a takeover competition between Acciona and Russian businessman Dimitry Lucenko, just days before the deadline for accepting - or topping - Lucenko's offer. Lucenko cried fraud and publicly warned foreign investors of the dangers of doing business in Serbia. Just days after the sale, U.S. investor Srba Ilic, the former owner of Putnik, received a decision from an international arbitration tribunal ruling that the Privatization Agency acted without cause in canceling his purchase of Putnik and ordering the GOS to pay Ilic some USD 12 million in compensation. END SUMMARY

ACCIONA EXPLOITS LOOPHOLE IN LAW TO ACQUIRE PUTNIK SHARES

¶2. (U) On Friday, April 20, Cyprus-based Acciona Investments Limited became the new owner of the Putnik travel agency by acquiring the Government of Serbia's (GOS) 70 percent stake for EUR 38 million on the Belgrade Stock Exchange. Acciona, part of Russian construction-to-tourism company Metropol, had opened the takeover battle for Putnik in early March. The competition drew a second bidder, Russian businessman Dimitry Lucenko, a director of Russia-based construction-to-pharmaceuticals corporation Mirax Group. Putnik owns Sveti Marko Island, a prime development property off the coast of Montenegro, as well as several hotels.

¶3. (U) Acciona initiated the takeover and obtained approval from the Securities Commission on March 12. Its initial offer was RSD 3,600 per share for between 70 and 85 percent of Putnik, or roughly EUR 28 million. The offer also included a non-binding commitment to invest EUR 20 million in overhaul of Putnik tourist facilities and in employee training. Acciona pledged to repay Putnik's debts of some EUR 12 million, provide a generous redundancy program, and sweetened the deal by offering a one-off payment of EUR 500 to each employee.

¶4. (U) On March 19, DCM wrote to the director of the Privatization Agency, the director of the Share Fund and the president of the Securities Commission, to request that the GOS refrain from any action with regard to the Putnik shares in light of the pending international arbitration over cancellation of the sales-purchase agreement by which U.S. investor Srba Ilic acquired Putnik. DCM noted that any transaction involving the shares could prejudice implementation of the tribunal's decision, in the event that

Uniworld, Ilic's company, wins. (Note: On May 4, the tribunal delivered its decision in favor of Ilic.)

¶5. (U) Nonetheless, on March 28, the Privatization Agency decided to cancel an already scheduled tender for the sale of Putnik shares, thereby freeing the Share Fund to accept Acciona's takeover bid or simply sell the shares on the exchange. Other suitors were invited to bid by April 2, when Acciona's offer closed. Lucenko submitted a counter offer on March 30 of RSD 3,700 per share for up to 85 percent, or roughly EUR 29.1 million. He offered to increase investment in Putnik's tourist facilities to EUR 30 million, repay company debt, and offered a one-off payment of EUR 600 to each employee. This counter bid was valid through April 23.

¶6. (U) Acciona responded by publicly questioning Lucenko's takeover bid and asking the Securities Commission to examine its validity, stating that Lucenko lacked financial backing. It also floated the allegation that perhaps Lucenko intended to buy Putnik with "connected persons," mentioning Mirax Corporation.

¶7. (U) Lucenko countered that he would not be intimidated by Acciona's attempts to "disqualify competition," and on April 18, he sweetened the offer to RSD 5,550 per share, which put the value of the 85 percent stake at EUR 34 million. That same day, Acciona withdrew its offer, citing dissatisfaction over the failure of the Securities Commission to investigate whether Lucenko was bidding with other unknown entities.

¶8. (U) On Thursday afternoon, April 19, the Share Fund announced - on its website - that 70 percent of Putnik shares would be offered on the stock exchange the next day, Friday, April 20. Lucenko was prohibited by the Securities Law from

purchasing these shares on the market, since he had a valid bid in a takeover procedure. Subsequently, Acciona purchased the state's stake at 6,000 dinars per share, or roughly EUR 38 million in total. This all occurred before Lucenko's offer became valid on April 23. Lucenko has now filed a complaint with the Commercial Courtin Belgrade to suspend settlement on the deal, after which he plans to sue the Share Fund over its decision to sell the shares on the Belgrade Stock Exchange, while his takeover bid was pending.

GOVERNMENT CONTENDS IT RESCUED PUTNIK FROM BANKRUPTCY
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¶9. (U) Aleksandar Gracanac, director of the Share Fund, characterized the Share Fund's actions as almost heroic in an April 24 press conference. He said that the day of the sale had been tense, with Putnik's debt reaching EUR 13 million and the looming threat of bankruptcy. (Note: Gracanac's assertion of bankruptcy risk is not credible; Belgrade judges frequently refuse to declare bankruptcies, even when there is cause.) He cited Uniworld's filing with the Commercial Court on Monday, April 16, of a request for a temporary ban on the takeover until the arbitration decision was handed down. Gracanac indicated that the Share Fund moved quickly to finish the deal before the first hearing in the Commercial Court on Friday, April 20. A decision from the hearing could have jeopardized the takeover. "We did this in the best interest of the state following the law," the director said.

¶10. (U) Minister of Economy Predrag Bubalo said, on television show "Poligraf," that the "privatization of Putnik has been implemented in accordance with the law and at the right moment because of the bankruptcy threat." He noted that the Agency had announced on March 27 its decision to sell Putnik through takeover or a share sale on the market, with the buyer to be determined according to the best offers under a transparent procedure: "The Share Fund offered the package of shares at the stock market in accordance with its legal authorizations, and the Share Fund did not have to announce again its intentions to do so apart from the March 27 announcement."

SALE IRREGULARITIES

¶11. (SBU) Marko Micanovic, a securities expert at Altis Capital in Belgrade, told econoff that there were several irregularities with the sale of Putnik's shares. It is telling that Acciona withdrew its offer on Wednesday, yet had the money and paperwork completely in order on Thursday to make the purchase on Friday. He said that, the day after Acciona withdrew its takeover bid, brokers could see that a large buy order at market price was placed for 70 percent shares of Putnik. He believes that Acciona likely used its funds from the takeover to make the purchase.

¶12. (SBU) Micanovic described the GOS's decision to sell the shares on the exchange as "dubious" given a valid takeover bid on the table. Usually, the Share Fund offers on the exchange a stake between 25 and 35 percent in companies it is selling. Selling 70 percent at once is highly unusual, he said. In addition, since the buy order was at market price, the Share Fund's broker could have made the sale at the highest fluctuation price of RSD 7,200 per share. It is unclear why the shares instead were sold at only RSD 6,000, a difference which cost the government EUR 7.7 million.

¶13. (U) The takeover law is designed to permit a bidding competition, to obtain the highest possible price for shareholders. Instead, the state opted to sell at a price marginally higher than the takeover offer, without permitting Lucenko to better his offer. One observer pointed out that the state could have ordered its broker to use an auction method of selling the shares, even without formally tendering its shares through the takeover. Instead, the Share Fund specified a method that capped the price at RSD 7,200, then apparently ordered its brokers to sell at RSD 6,000.

U.S INVESTOR FINALLY WINS AGAINST GOS

¶14. (U) The Privatization Agency terminated the sales-purchase agreement (SPA) with U.S. investor Uniworld Holdings in July 2005, based on its claim that Uniworld failed to meet investment obligations under the SPA (see reftel for history). Since then, the Agency tried several times - unsuccessfully - to sell Putnik assets. In September 2005, the Agency tried to sell Putnik via a tender, but Uniworld obtained a court order that the Agency can not Qown, manage, sell or encumber shares of PutnikQ until the completion of the International Arbitration.

¶15. (U) The Agency then tried to sell Sveti Marko Island in Montenegro, Putnik's most valuable asset. The 30-hectare island represents about 90 percent of Putnik's estimated worth of EUR 150 million. The Agency contended that while the court order prohibited them from selling Putnik's shares, it did not preclude asset sales. Uniworld once again obtained a court order from the Commercial Court in Belgrade to ban the auction, affirming that Uniworld was still legal owner of the shares until the international arbitration decided otherwise. While the GOS was able to overturn this decision via an appeal to the Supreme Court, Uniworld still was able to block the sale via the Montenegrin courts.

¶16. (SBU) Srba Ilic, owner of Uniworld Holdings, told econoff that he believes the GOS's approval of the takeover procedure and subsequent "fire sale" on the open market was a move to sell Putnik's assets before the International Court rendered its decision.

¶17. (SBU) On May 4, the International Court handed down its decision in favor of Uniworld. Ilic was awarded USD 12.685 million plus interest, which covers his USD 5.2 million purchase price, USD 1.6 million in partial return of investments, return of the excursion vessel "Sirona", USD 2.2 million for reimbursement of the first bank guarantee cashed

by the privatization agency, and USD 82,500 for arbitration costs. (Note: Ilic had an OPIC insurance policy on the performance bond.) Ilic has a second arbitration pending for another tourist agency he had purchased through privatization, only to have the Agency cancel his contract.

COMMENTS

¶18. (U) GOS behavior in the Putnik tale is telling. All parties to the Uniworld arbitration knew that the decision was imminent; the Share Fund's haste clearly was an attempt to evade the consequences of an unfavorable decision. At the same time, the manner of the sale suggests collusion between the Share Fund and Acciona. The fact that the shares were sold at a predetermined price, without using an auction or awaiting the end of the takeover to flush out the highest price, demonstrates that obtaining best value for Serbian taxpayers was not a key motivation in the Share Fund's decision. Indeed, by selling on the market, rather than by tender, the GOS gave up its leverage to lock in investment commitments or pledges to workers; Acciona's promises are now unenforceable. We wonder whether the impending change in government, and the chance to make a fast buck before key officials surrender ministerial seats, may have played a role in this sorry affair. Our message to the GOS will be simple: honor the arbitration results and pay Ilic in full.

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